DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 98-0195 SLOF
For Years 1992, 1993, and 1994

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ISSUE

I. **Gross Retail Tax on Materials Incorporated Into Realty**: Agreements to Improve Taxpayer's Realty Characterized as Lump Sum Contracts.

Authority: IC 6-2.5-8-9; IC 6-8.1-5-1(b); Wabash Grain, Inc. v. Smith, 700 N.E.2d 234 (Ind. Ct. App. 1998); Farrington v. Allsop, 670 N.E.2d 106 (Ind. Ct. App. 1996); 45 IAC 2.2-4-22(e); 45 IAC 2.2-4-26(a); 45 IAC 2.2-8-16(c).

Taxpayer has requested a rehearing for the limited purpose of determining whether 12 agreements, entered into between the taxpayer and various contractors, constituted lump sum contracts for the improvement to realty.

Statement of Facts

Taxpayer is a steel producer operating steel plants throughout the world including a facility located in Indiana. At various times, the taxpayer and certain contractors entered into agreements for the improvement of the property and buildings at the Indiana facility. These agreements were one of the topics addressed in a Letter of Findings previously issued by the Department. However, at that time the issue of whether the agreements were lump sum contracts was intertwined with the issue of the appropriateness of the taxpayer's use of its Direct Pay Permit in arriving at those agreements.

DISCUSSION

I. **Gross Retail Tax on Materials Incorporated Into Realty**.

Taxpayer has requested a rehearing for the purpose of determining whether certain agreements, entered into between itself and its contractors, constituted lump sum contracts for the improvement to realty. The significance of this distinction lies in the fact that the taxpayer is not subject to use tax liability for those transactions, entered into for the purpose of improving the taxpayer's realty, in which the agreement was couched in

terms of a lump sum contract. Under 45 IAC 2.2-4-22(e), "With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner: (1) He converts the construction material into realty on land he owns and then sells the improved real estate; (2) He utilizes the construction material for his own benefit; or (3) Lump sum contract. *He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price."* (Emphasis added). Accordingly, the contractor will either pay the gross retail tax "up-front" when he initially purchases the construction materials or he will pay the gross retail tax in the form of use taxes when the materials are incorporated into the construction project. Either up-front or at the point where the materials are incorporated into the taxpayer's realty, in lump sum contracts between the taxpayer and its contractors, it is the contractors who are ultimately responsible for paying the tax on the construction materials. 45 IAC 2.2-4-26(a) provides that "[a] person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of the all material so used."

The taxpayer has described its contracting process as typically encompassing a series of specific steps. The first step involves taxpayer's in-house development of project specifications. The second step involves the issuance of a "purchase order" which constitutes the initial and primary agreement between the taxpayer and contractor. This purchase order, quite abbreviated in form, incorporates by reference the taxpayer's standard contract terms. (*See* Exhibit B, C, Taxpayer Fax, Dec. 4, 2000; Taxpayer Fax, Standard Specifications Part 2.0, Dec. 8, 2000). The purchase order includes a single price specification that is intended as the unit price for the project and is intended to represent both the contractor's labor and material costs. (Exhibit C, Taxpayer Letter, Dec. 4, 2000). Also incorporated, by indirect reference, into certain of the purchase orders, is a provision whereby the contractor is entitled to progress payments. A provision to that effect is found at Exhibit C3, page 2, wherein it states that the contract payments may be made in the form of progress payments. These progress payments, issued during the period during which the project is underway, are initiated by the contractor in the form of a "progress payment request." That request states the cost of materials incorporated and the cost of labor expended within a particular construction project up to a certain point in that construction project. These "progress payment requests" generate paperwork which includes specific references to both the labor and material costs. Purportedly, this paperwork is ancillary to the parties' initial agreement (purchase order) and does not transform what was intended by the parties as a lump sum contract into a time and materials contract. Rather the detailed information included in the progress payment request is intended to justify the contractor's request for the payment.

Taxpayer has requested a determination that 12 specific contracts are lump sum contracts. This request necessitates a listing of those contracts which is as follows:

Vendor	Purchase Order	Taxable Amount	Total Amount
1. Contractor 1	559970	201.00	4,900.00
2. Contractor 2	564124	2,950.00	403,500.00
3. Contractor 3	563936	22,500.00	1,140,000.00
4. Contractor 4	563650	3,083.00	5,433.00
5. Contractor 5	560204	1,010.00	5,866.00
6. Contractor 6	560403	4,074.00	9,898.60
7. Contractor 7	564567	48,250.00	82,472.20
8. Contractor 8	562487	5,000.00	79,900.00
9. Contractor 9	562454	60,337.00	335,290.00
10. Contractor 10	924496	19,000.00	20,000.00
11. Contractor 11	559514	255,684.00	840,000.00
12. Contractor 12	562764	1,113,977.00	28,490,539.00

The taxpayer has met its burden of demonstrating that the first 11 of the purchase orders, to the extent that those purchase orders are enumerated within this letter of findings, are lump sum contracts for making improvements to the taxpayer's realty. Accordingly, the taxpayer typically would not be liable for use tax on any portion of the contract cost when it is the contractor who is responsible for paying that use tax. As set out in Information Bulletin Number 60, Dec. 2, 1987, "A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase of all material so used." The fact that taxpayer received requests for progress payments from its contractors, relevant to these particular lump sum contracts, which included a listing of both material and labor costs, does not vitiate this determination. "The fact that the seller subsequently furnishes information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material." Id.

However the analysis of taxpayer's contracts one through eleven does not end with the determination that they constitute lump sum contracts. On four of the eleven contracts (one, five, six, and eleven) the taxpayer has included a printed claim that it is "exempt from state sales tax." Taxpayer apparently predicates this rather sweeping assertion on the ground that taxpayer possesses a Direct Pay Permit. The statutory provision governing the use of Direct Pay Permits is somewhat more restrictive than that which the taxpayer has apparently represented to its contractors. The taxpayer's Direct Pay Permit is not a global declaration that the taxpayer is entitled to any tax exemption. Rather, the Direct Pay Permit is an agreement between the taxpayer and the department that the taxpayer "will pay the tax . . . directly to the Department." IC 6-2.5-8-9(b). The Direct Pay Permit merely allows taxpayer the option of determining the taxability of the purchased items at a later time. If, at that later time, those purchased items are determined to be taxable, the taxpayer pays the tax. However, taxpayer cannot escape the fact that, when using its Direct Pay Permit, the ultimate responsibility for the tax remains with the taxpayer.

The taxpayer's assertion to its contractors that it is "exempt from state sales tax" is entirely inappropriate. 45 IAC 2.2-8-16(c) clearly states that "[a] direct payment permit is not a declaration that the issuer is entitled to [an] exemption, but is rather a declaration that the issuer will remit use tax on any purchase on which sales tax was due."

For contracts numbers one, five, six, and eleven – otherwise determined to be lump sum contracts – the taxpayer is precluded from asserting an exemption for the use tax liability otherwise available under 45 IAC 2.2-4-22(e) and 45 IAC 2.2-4-26(a), on two grounds. First, the taxpayer is precluded from claiming the exemption from use tax liability on equitable estoppel grounds. "Equitable estoppel is available if one party, through its representations or course of conduct, knowingly misleads or induces another party to believe and act upon his conduct in good faith and without knowledge of the facts." Wabash Grain, Inc. v. Smith, 700 N.E.2d 234, 237 (Ind. Ct. App. 1998). "The basis for the doctrine of equitable estoppel is fraud, either actual or constructive, on the part of the person estopped." Farrington v. Allsop, 670 N.E.2d 106, 109 (Ind. Ct. App. 1996). "Constructive fraud is fraud that arises by operation of the law from conduct which, if sanctioned by the law, would secure an unconscionable advantage." Id. Although no evidence has been presented which establishes that taxpayer, by making an unsubstantiated claim that it was "exempt from sales tax," intended to commit fraud, no direct evidence of fraud is required to assert the doctrine. Rather, "in order to prevail on a theory of constructive fraud, one need not establish the existence of an actual intent to defraud." Id. Instead, it is the taxpayer's "conduct [that] triggers the application of the Id. When taxpayer states on its purchase orders that it is "exempt from sales tax," one can come to the reasonable conclusion that the statement was intended to lead taxpayer's contractors to believe that taxpayer was "exempt from sales tax." Taxpayer may not so mislead its contractors, claim a lump sum contract exemption, and escape the tax liability it willingly assumed to itself when the taxpayer applied for its Direct Pay Permit – the very basis on which it now incorrectly asserts a tax exempt status.

Second, the taxpayer is barred from claiming the lump sum contract exclusion, for those contracts on which it claimed that it was "exempt from sales tax," based upon the obligations it assumed when it applied for and received its Direct Pay Permit. The Direct Pay Permit is a convenience made available to a taxpayer permitting that taxpayer an opportunity to defer the payment of gross retail tax but in no way alleviating the taxpayer from the responsibility for the tax liability. IC 6-2.5-8-9(a), (b). Having taken upon itself the opportunity of acquiring a Direct Pay Permit, having represented to its contractors that it is "exempt from sales tax," and having presented no evidence that its contractors paid the gross retail tax on those materials incorporated into the taxpayer's realty, the taxpayer is left with the statutory obligation – voluntarily assumed by the taxpayer – to "pay the tax on that purchase directly to the department. IC 6-2.5-8-9(b). Having made certain representations to its contractors, apparently predicated on its possession of a Direct Pay Permit, the contractors were quite reasonably entitled to assert that they "had no duty to collect or remit the state gross retail or use tax on [each] transaction." IC 6-2.5-8-9(b).

Taxpayer has failed to meet its burden of demonstrating that purchase order number 12 is a lump sum contract. Under IC 6-8.1-5-1(b), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." In regard to purchase order number 12, the taxpayer has set forth a bare assertion, unsupported by documentary evidence of the original agreement, that purchase order number 12 is a lump sum contract. Taxpayer has submitted secondary evidence, relating to a later modification of the original purchase order, which purportedly gives evidence of the parties' intent to consummate a lump sum agreement. Taxpayer Facsimile, Dec. 15, 2000. However, that secondary evidence, standing alone, is insufficient to establish the nature of the original purchase order and is insufficient to rebut the presumption afforded under IC 6-8.1-5-1(b).

Having determined that the seven remaining contracts are lump sum contracts for which the taxpayer is not obligated to pay the gross retail tax, it is fitting to remind the taxpayer concerning the appropriateness of representations set forth on those contracts. On those seven contracts, the taxpayer has included the statement that it possesses a "direct payment authorization." Exhibit C, Taxpayer Letter, Dec. 4, 2000. Taxpayer's purpose in making this representation remains obscure but, nonetheless, the taxpayer is reminded that "[d]irect payment permits do not certify that the issuer is entitled to an exemption and *may not be issued to flat bid (lump sum) contractors."* Ind. Dept. of Revenue Application for Direct Pay Authorization (Emphasis added).

FINDING

The taxpayer's protest is denied in part and sustained in part.